IN THE

SUPREME COURT OF THE UNITED STATES

NO. 78-442

OTM CORPORATION,

Petitioner,

VS.

UNITED STATES OF AMERICA,

Respondent.

PETITIONER'S APPENDICE FOR ITS WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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APPENDIX A

IN THE UNITED STATES DISTRICT COURT FOR THE

SOUTHERN DISTRICT OF TEXAS

HOUSTON DIVISION

OTM CORPORATION,	:	
	:	
Plaintiff	:	
	:	
VS.	:	CIVIL NO. 70-H-145
	:	
UNITED STATES OF AMERICA,	:	
	:	
Defendant.	:	

FINDINGS OF FACT
AND CONCLUSIONS OF LAW

This matter came on to be heard before this Court sitting without a jury, and the parties having by their pleadings and by stipulations established the evidence, this Court enters its findings of fact and conclusions of law:

Findings of Fact

1. This is a suit brought by the plaintiff, OTM Corporation, against the United States of America, for a refund of

federal income taxes paid by OTM for its fiscal years ended September 30, 1955, through September 30, 1958, in the principal amount of $53,646.44, plus a negligence penalty, assessed interest and statutory interest thereon.

2. Plaintiff is a corporation incorporated under the laws of the State of Texas with its place of business at Houston, Texas. Defendant is the United States of America.

3. Originally, this case involved a number of issues concerning rental deductions claimed by the plaintiff of equipment which it rented from an associated company, Texas Industrial Equipment Rental Co. (TIERCO), and the deductibility of various miscellanous items. The plaintiff has conceded that the Government properly assessed and collected the tax with respect to all of the miscellaneous items and they are no longer in issue in this action.

only the question of the proper rental deduction remains for consideration by the Court.

4. During the years at issue, the plaintiff, OTM, was owned 51 percent by J. C. Bradshaw, 48 percent by Kenneth Bradshaw, his adult son, and the remainder by others. TIERCO was owned one-third by J. C. Bradshaw, one-third by Kenneth Bradshaw, and one-third by James Hull, an independent C.P.A., who was the auditor for OTM.

5. During the years at issue, TIERCO rented equipment to OTM. The Government, following an audit of OTM's income tax return, disallowed a portion of the rental as a business deduction pursuant to Section 162 of the Internal Revenue Code of 1954 on ten of the items of equipment. The parties have agreed that the reasonable rental value of those items of the equipment in dispute was such that a

refund of federal tax in the amount of $17,474, plus assessed interest, was proper and appropriate. This Court has examined the record and adopts the stipulation of the parties with respect to the reasonable rental value.

6. At the same time that the Government denied a deduction for excess rentals paid by OTM to TIERCO, it did not reduce TIERCO's income by an equal sum. At the time the assessment was made against OTM, the statute of limitations for assessment against and claims for refund by TIERCO had not yet run. The Government did not voluntarily reduce TIERCO's rental income and TIERCO took no legal action to claim a refund of amounts previously paid by it as taxes on rental income. Statutes of limitation on assessment against and claims for refund by TIERCO have, of course, since elapsed.

7. TIERCO paid some $17,474. in

income tax by virtue of its receipt of income equal to the disallowed deductions for excessive rental expense to OTM.

8. The parties have agreed that the negligence penalty of five percent assessed against OTM will apply; however, the negligence penalty will not be applied to amounts refunded to OTM pursuant to the stipulation of the parties. Accordingly, with respect to the $17,474. to be refunded to the plaintiff pursuant to the stipulation of the parties, there will also be a refund of $654.00 in negligence penalty.

9. Any conclusion of law deemed to be a finding of fact is hereby adopted as the same.

Conclusions of Law

1. This Court has jurisdiction of the subject matter and of the parties. Venue is proper and this lawsuit is properly brought in this Court.

2. Following the stipulation of the

parties on the reasonable rental value of the equipment and the concession by the plaintiff of the miscellaneous issues, there remains but one issue for decision by the Court: Whether the failure of the Government to reduce TIERCO's income by an amount equal to the disallowed deductions for OTM somehow prohibits the Government from disallowing those deductions to OTM. This issue requires brief reference to Sections 162 and 482 of the Internal Revenue Code of 1954 (26 U.S.C.).

3. Section 162 allows a business to deduct the ordinary and necessary costs of conducting its business. Tulia Feedlot, Inc. v. United States, 513 F.2d 800 (C.A. 5, 1975), cert. denied, 423 U.S. 947 (1975). With respect to rentals, only those sums which are reasonable in amount are allowed as a Section 162 deduction. Brown Printing Co. v. Commissioner, 255 F.2d 436 (C.A. 5, 1958). It was pursuant to these princi-

ples that the Government, in its assessment, disallowed a portion of the deductions claimed by OTM for rental expense.

4. In a case involving two businesses which are controlled by the same interests, the Government has an alternative weapon--Section 482 of the Internal Revenue Code of 1954--which allows it to allocate income and deductions amongst such businesses. The Government did not purport to use Section 482 in this case, although it might have done so. In cases involving Section 482 the Government is required to make a correlative adjustment. That is, if it were to disallow deductions to OTM, it would also have to reduce TIERCO's rental income by a like amount. Treasury Regulations on Income Tax (1954 Code), §1.482-1(d)(2) (26 C.F.R.). Here, OTM claims that, because the Government did not reduce TIERCO's income, it is somehow estopped from denying the deduction to OTM

on the basis of Section 162.

5. The law provides that Section 482 may be used only at the instance of the Government--it may not be claimed by a taxpayer nor can the Government be compelled to use the principles of Section 482 in a given circumstance. Treasury Regulations § 1.482-1(b)(3).

6. Accordingly, because the Government did not use Section 482 and cannot be compelled to, OTM cannot complain that TIERCO's income was not reduced, i.e., no correlative adjustment was made. The Government's assessment was made solely by virtue of the principles of Section 162 which do not require a correlative adjustment. In such a case, TIERCO might have (but did not choose to) filed a suit for a refund of taxes. If TIERCO had chosen to do so, its suit might well have been joined with that of OTM in order to obtain complete adjudication. However, there is

no requirement that the Government adjust TIERCO's income under the principles of Section 162; it was up to TIERCO to do something about it.

7. Accordingly, this Court concludes that OTM's point is not well taken. The Government, having made its assessment pursuant to Section 162 is entitled to prevail as to the disallowance of that portion of the rental expense over and above the stipulated fair rental value.

8. If any finding of fact is deemed to be a conclusion of law, it is hereby adopted as the same.

The parties are hereby directed to prepare a judgment in conformity with these findings of fact and conclusions of law and submit them to the Court for entry.

Done at Houston, Texas, this 30th day of September, 1977.

/s/ Woodrow Seals
UNITED STATES DISTRICT JUDGE

IN THE UNITED STATES DISTRICT COURT FOR THE

SOUTHERN DISTRICT OF TEXAS

HOUSTON DIVISION

OTM CORPORATION,	:	
	:	
Plaintiff	:	
	:	
VS.	:	CIVIL NO. 70-H-145
	:	
UNITED STATES OF AMERICA,	:	
	:	
Defendant	:	

JUDGMENT

This matter having come on to be heard before the Court, sitting without a jury, and the Court having considered the stipulation of the parties, the pleadings, and the evidence, and having rendered its findings of fact and conclusions of law, in accordance therewith it is hereby

ORDERED, ADJUDGED AND DECREED that the plaintiff, OTM, do have and recover of the defendant, United States of America, for its fiscal years ended September 30, 1955, through September 30, 1958, the sum of $45,754., consisting of $17,474. in prin-

cipal, penalty in the amount of $654, assessed interest in the amount of $2,189, and statutory interest thereon in the amount of $25,440 to September 21, 1977, with statutory interest thereafter pursuant to law, and with each party to bear its own costs.

Done at Houston, Texas, this 30th day of September, 1977.

/s/ Woodrow Seals
UNITED STATES DISTRICT JUDGE

APPROVED AS TO FORM ONLY:

/s/ Dougal C. Pope
DOUGAL C. POPE
Pope and Waits
2317 Bissonnet
Houston, Texas 77005

ATTORNEY FOR PLAINTIFF

JAMES R. GOUGH
United States Attorney

By: /s/ Howard A. Weinberger
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Dallas, Texas 75242
(214) 749-1251

ATTORNEY FOR DEFENDANT

APPENDIX B

IN THE

UNITED STATES COURT OF APPEALS

FOR THE FIFTH CIRCUIT

NO. 77-3200
Summary Calendar*

OTM CORPORATION,

Plaintiff-Appellant,

versus

UNITED STATES OF AMERICA,

Defendant-Appellee.

(May 8, 1978)

Appeal from the United States District Court for the Southern District of Texas

---

Before RONEY, GEE, AND FAY, Circuit Judges

PER CURIAM: The judgment is affirmed on the basis of the Findings of Facts and Conclusions of Law of the District Court annexed hereto.

Appendix to follow

*Rule 18, 5 Cir.; See Isbell Enterprises, Inc. v. Citizens Casualty Co. of New York, et al, 5 Cir., 1970, 431 F.2d 409, part 1.

OTM CORPORATION VS. UNITED STATES

Appendix

IN THE UNITED STATES DISTRICT COURT FOR THE

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HOUSTON DIVISION

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	:	
Plaintiff,	:	
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with respect to all of the miscellaneous items and they are no longer in issue in this action. Only the question of the proper rental deduction remains for consideration by the Court.

4. During the years at issue, the plaintiff, OTM, was owned 51 percent by J. C. Bradshaw, 48 percent by Kenneth Bradshaw, his adult son, and the remainder by others. TIERCO was owned one-third by J. C. Bradshaw, one-third by Kenneth Bradshaw, and one-third by James Hull, an independent C.P.A., who was the auditor for OTM.

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9. Any conclusion of law deemed to be a finding of fact is hereby adopted as the same.

Conclusions of Law

1. This Court has jurisdiction of the subject matter and of the parties. Venue is proper and this lawsuit is properly

brought in this Court.

2. Following the stipulation of the parties on the reasonable rental value of the equipment and the concession by the plaintiff of the miscellaneous issues, there remains but one issue for decision by the Court: Whether the failure of the Government to reduce TIERCO's income by an amount equal to the disallowed deductions for OTM somehow prohibits the Government from disallowing those deductions to OTM. This issue requires brief reference to Sections 162 and 482 of the Internal Revenue Code of 1954 (26 U.S.C.).

3. Section 162 allows a business to deduct the ordinary and necessary costs of conducting its business. Tulia Feedlot, Inc. v. United States, 513 F.2d 800 (C.A. 5, 1975), cert. denied, 423 U.S. 947, 96 S.Ct. 362, 46 L.Ed.2d 281 (1975). With respect to rentals, only those sums which are reasonable in amount are allowed as a

Section 162 deduction. Brown Printing Co. v. Commissioner, 255 F.2d 436 (C.A. 5, 1958). It was pursuant to these principles that the Government, in its assessment, disallowed a portion of the deduction claimed by OTM for rental expense.

4. In a case involving two businesses which are controlled by the same interests, the Government has an alternative weapon--Section 482 of the Internal Revenue Code of 1954--which allows it to allocate income and deductions amongst such businesses. The Government did not purport to use Section 482 in this case, although it might have done so. In cases involving Section 482 the Government is required to make a correlative adjustment. That is, if it were to disallow deductions to OTM, it would also have to reduce TIERCO's rental income by a like amount. Treasury Regulations on Income Tax (1954 Code), §1.482-1(d)(2)(26 C.F.R.). Here, OTM claims that,

because the Government did not reduce TIERCO's income, it is somehow estopped from denying the deductions to OTM on the basis of Section 162.

5. The law provides that Section 482 may be used only at the instance of the Government--it may not be claimed by a taxpayer nor can the Government be compelled to use the principles of Section 482 in a given circumstance. Treasury Regulations §1.482-1(b)(3).

6. Accordingly, because the Government did not use Section 482 and cannot be compelled to, OTM cannot complain that TIERCO's income was not reduced, i. e., no correlative adjustment was made. The Government's assessment was made solely by virtue of the principles of Section 162 which do not require a correlative adjustment. In such a case, TIERCO might have (but did not choose to) filed a suit for a refund of taxes. If TIERCO had chosen to

do so, its suit might well have been joined with that of OTM in order to obtain complete adjudication. However, there is no requirement that the Government adjust TIERCO's income under the principles of Section 162; it was up to TIERCO to do something about it.

7. Accordingly, this Court concludes that OTM's point is not well taken. The Government, having made its assessment pursuant to Section 162 is entitled to prevail as to the disallowance of that portion of the rental expense over and above the stipulated fair rental value.

8. If any finding of fact is deemed to be a conclusion of law, it is hereby adopted as the same.

The parties are hereby directed to prepare a judgment in conformity with these findings of fact and conclusions of law and submit them to the Court for entry.

Done at Houston, Texas, this 30 day of

September, 1977.

/s/ Woodrow Seals
UNITED STATES DISTRICT JUDGE

IN THE UNITED STATES COURT OF APPEALS

FOR THE FIFTH CIRCUIT

NO. S77-3200

OTM CORPORATION,

Plaintiff-Appellant,

versus

UNITED STATES OF AMERICA,

Defendant-Appellee.

- - - - - -

Appeal from the United States District Court
for the Southern District of Texas

- - - - - -

(June 27, 1978)

Before RONEY, GEE, AND FAY, Circuit Judges

BY THE COURT:

It is ordered that appellant's motion for leave to file petition for rehearing out of time is GRANTED and, upon consideration, the petition for rehearing is denied.

/s PHR

6/8/78 /s G

/s F

APPENDIX C

Statutes Involved

26 U.S.C. 482 provides:

Sec. 482. Allocation of income and deductions among taxpayers.

In any case of two or more organizations, trades, or businesses (whether or not incorporated, whether or not organized in the United States, and whether or not affiliated) owned or controlled directly or indirectly by the same interests, the Secretary may distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among such organizations, trades, or businesses, if he determines that such distributions, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any of such organizations, trades, or businesses.

26 U.S.C. 162 provides:

Sec. 162. Trade or business expenses.

(a) In general.--There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including--

* * * *

(3) rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

* * * *

Regulations Involved

Reg. §1.482-1(b)(1) provides:

(b) Scope and purpose.

(1) The purpose of section 482 is to place a controlled taxpayer on a tax parity with an uncontrolled taxpayer, by determining, according to the standard of an uncontrolled taxpayer, the true taxable income from the property and business of a controlled taxpayer. The interests controlling a group of controlled taxpayers are assumed to have complete power to cause each controlled taxpayer so to conduct its affairs that its transactions and accounting records truly reflect the taxable income from the property and business of each of the controlled taxpayers. If, however, this has not been done, and the taxable incomes are thereby understated, the district director shall intervene, and, by making such distributions, apportionments, or allocations as he may deem necessary of gross income, deductions, credits, or allowances, or of any item or element affectly taxable income, between or among the controlled taxpayers constituting the group, shall determine the true taxable income of each controlled taxpayer. The standard to be applied in every case is that of an uncontrolled taxpayer dealing at arm's length with another uncontrolled taxpayer.

Reg. §1.482-1(b)(2) provides:

> (2) Whenever the district director makes adjustments to the income of one member of a group of controlled taxpayers (such adjustments being referred to in this paragraph as "primary" adjustments) he shall also make appropriate correlative adjustments to the income of any other member of the group involved in the allocation....

Reg. §1.482-2(c) provides:

> (c) Use of tangible property.
>
> (1) General rule.
> Where possession, use, or occupancy of tangible property owned or leased by one member of a group of controlled entities (referred to in this paragraph as the owner) is transferred by lease or other arrangement to another member of such group (referred to in this paragraph as the user) without charge or at a charge which is not equal to an arm's length rental charge (as defined in subdivision (i) of subparagraph (2) of this paragraph), the district director may make appropriate allocations to properly reflect such arm's length charge....
>
> * * * *
>
> (2) Arm's length charge.
> (i) For the purposes of this paragraph, an arm's length rental charge shall be the amount of rent which was charged, or would have been charged for the use of the same or similar property, during the time it was in use, in independent transactions with or between unrelated parties under similar circumstances considering the period and location of the use, the owner's investment in the property or rent paid for the property....

Reg. §1.482-1(a)(6) provides:

> The term "true taxable income" means, in the case of a controlled taxpayer, the taxable income (or, as the case may be, any item or element affecting taxable income) which would have resulted to the controlled taxpayer, had it in the conduct of its affairs (or, as the case may be, in the particular contract, transaction, arrangement, or other act) dealt with the other member or members of the group at arm's length. It does not mean the income, the deductions, the credits, the allowances, or the item or elements of income, deductions, credits, or allowances, resulting to the controlled taxpayer by reason of the particular contract, transaction, or arrangement, the controlled taxpayer, or the interests controlling it, chose to make (even though such contract, transaction, or arrangement be legally binding upon the parties thereto).

Reg. §1.482-1(c) provides:

> Application. Transactions between one controlled taxpayer and another will be subjected to special scrutiny to ascertain whether the common control is being used to reduce, avoid, or escape taxes. In determining the true taxable income of a controlled taxpayer, the district director is not restricted

to the case of improper accounting, to the case of a fraudulent, colorable, or sham transaction, or to the case of a device designed to reduce or avoid tax by shifting or distorting income, deductions, credits, or allowances. The authority to determine true taxable income extends to any case in which either by inadvertence or design the taxable income, in whole or in part, of a controlled taxpayer, is other than it would have been had the taxpayer in the conduct of his affairs been an uncontrolled taxpayer dealing at arm's length with another controlled taxpayer.